

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Duvall Analyst: Jennifer Bettencourt Bill Number: AB 1040
Related Bills: See Legislative History Telephone: 845-5163 Introduced Date: February 22, 2007
Attorney: Tommy Leung Sponsor: _____

SUBJECT: Medical Care Costs Deduction

SUMMARY

This bill would allow a deduction for medical care expenses.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to allow taxpayers to deduct medical care expenses without any of the limitations contained in existing law.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning January 1, 2007.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Current federal and state laws allow an itemized deduction for expenses paid during the taxable year that are not compensated by insurance or otherwise for the medical care of the taxpayer, the spouse of the taxpayer, or the dependents of the taxpayer to the extent that the expenses exceed 7.5% of the taxpayer's adjusted gross income (AGI).

THIS BILL

This bill would allow a deduction equal to the cost not compensated by insurance or otherwise paid or incurred during the taxable year for medical care for the taxpayer, taxpayer's spouse, or the taxpayer's dependents.

The deduction would be allowed as an "above the line" deduction in computing the taxpayer's AGI.

Board Position:

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Department Director

Date

Selvi Stanislaus

4/26/07

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill contains undefined terms. Lack of definitions could cause disputes between taxpayers and the department. The author may wish to amend the bill to include definitions for "medical care" and "dependents." Adoption of Internal Revenue Code section 213 definitions, with necessary modifications for California law, would provide a definition of "medical care" and "dependents," and would clarify the requirements to qualify for this deduction.

LEGISLATIVE HISTORY

AB 2200 (Pacheco, 1999/2000) would have allowed a deduction for medical expenses in excess of \$1,000 for taxpayers who are 65 years or older. AB 2200 failed to pass out of the Assembly Revenue and Taxation Committee.

AB 2267 (Baugh, 1997/1998) was identical to this bill. AB 2267 failed to be heard in a policy committee in the first house. AB 2330 (Poochigian, 1997/1998) would have reduced the percentage of medical expenses that may be deducted from those exceeding 7.5% of AGI to those exceeding 2% of AGI over a five-year period. AB 2330 was held in the Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida does not have personal income tax. *Illinois, Massachusetts, Michigan, Minnesota, and New York* do not allow a deduction that is similar to this bill, but like California conform to the federal itemized deduction allowed for medical expenses, if the expenses exceed 7.5% of a taxpayer's AGI.

ECONOMIC IMPACT

Revenue Estimate:

This bill would result in the following revenue losses:

Revenue Impact Of AB 1040 Enactment Assumed After June 30, 2007 (\$ in Billions)			
	2007-8	2008-9	2009-10
Revenue Impact	-\$0.60	-\$2.80	-\$4.00

This estimate does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

Using national and state health care data, the out-of-pocket medical expenses for 2008 are projected to be approximately \$30 billion. This figure includes such items as co-payments and insurance premiums. Total health insurance premiums are projected to be \$23 billion for 2008. Premiums paid to cafeteria plans by employees are not included in an employee's gross income and cannot be deducted at the federal level; it is assumed these amounts would not be deductible under this bill and are not included in this estimate. Assuming a marginal tax rate of 6%, the revenue impact of this bill for 2008 would be approximately \$3 billion calculated as follows:

Total health care spending = \$30 billion + \$23 billion = \$53 billion

Revenue impact at 6% = $0.06 \times \$53 \text{ billion} = \$3 \text{ billion (rounded)}$

The numbers in the table above have been adjusted to reflect revenue estimates for fiscal years.

ARGUMENTS/POLICY CONCERNS

This bill would create a federal/state difference in computing AGI. California law would allow an "above-the-line" deduction for medical expenses, while federal law would continue to treat costs for medical care as a "below-the-line" deduction subject to an AGI limitation.

This bill would allow taxpayers in certain circumstances to claim multiple tax benefits for the same item of expense. This bill should specify that the deduction allowed under this section would be taken in lieu of any other credit or deduction under other provisions for qualified health expenses.

LEGISLATIVE STAFF CONTACT

Jennifer Bettencourt
Franchise Tax Board
845-5163
jennifer.bettencourt@ftb.ca.gov

Brian Putler
Franchise Tax Board
845-6333
brian.putler@ftb.ca.gov